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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1954

No. 37

MARION L. HOLLAND AND ETHEL E. HOLLAND, *Petitioners*,

v.

UNITED STATES OF AMERICA.

**On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit**

## BRIEF FOR THE PETITIONERS

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## BRIEF FOR THE PETITIONERS

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### OPINIONS BELOW

The District Court wrote no opinion. The Opinion of the Court of Appeals (R. 341-352) is reported at 209 F. 2d 516.

### JURISDICTION

The judgments of the Court of Appeals were entered on January 21, 1954 (R. 351). An order denying a petition for rehearing was entered on February 5, 1954 (R. 352).

An order staying the mandates of the Court of Appeals to March 7, 1954, was entered on February 8, 1954. On March 3, 1954, an order was entered by Mr. Justice Clark extending the time for the filing of a petition for writ of certiorari to March 22, 1954. On March 5, 1954, an order was entered by the Court of Appeals staying its mandates until March 22, 1954. The petition was filed on March 22, 1954, and granted on June 7, 1954 (R. 352). The jurisdiction of this Court is invoked under Title 28, USC § 1254.

## QUESTIONS PRESENTED

1. Where a taxpayer's books and records are complete and admittedly do not contain a single error which would result in an understatement of taxable income, may the Government substitute a different method of accounting, in this case the net worth method, and rely upon its net worth computations as the sole evidence to support a tax evasion prosecution?

2. (a) Absent evidence of any specific unreported item of income, of any undisclosed source of income, or of any improper deduction, may a criminal conviction for tax evasion, based entirely on net worth computations, be sustained where the Government has failed to establish with accuracy the net worth starting point, omitting from such starting point, among other things, substantial stock holdings as well as a critical item of cash, the existence or nonexistence of which was admitted by the Government's principal witness to be a matter of doubt?

(b) In such a case may the trial court permit the Government to shift to the taxpayer the burden of establishing the items which should or should not be included in the taxpayer's opening net worth?

(c) In such a case may the trial court refuse to instruct the jury that it is incumbent on the Government to establish the net worth of the taxpayer on the starting point date?

(d) In such a case may the Government rely upon a taxpayer's extra-judicial statement to establish the opening net worth without corroborating evidence?

3. (a) May the trial court limit the Government's burden of proving the crime charged to that of merely discrediting the taxpayer's extra-judicial statement.

(b) Does the Government have the burden of proving that asserted increases in net worth are attributable to taxable income, or, at the minimum, of introducing evidence tending to refute the possibility that such increases are attributable to non-taxable sources—or does the taxpayer, as the lower courts in substance held, have the burden of proving that such increases in net worth are not derived from currently taxable sources?

(c) Does the Government have the burden of proving willfulness by evidence independent of its net worth computations or may the jury be allowed to infer willfulness from asserted increases in net worth?

4. Is it proper to instruct the jury that the reasonable doubt which would require a verdict of acquittal in the criminal case is the "kind of doubt" which the jury "*might be willing to act upon* in their more serious and important affairs", as distinguished from an instruction to the effect that the doubt must be of a kind which would lead the jury *to hesitate to act* or *refrain from acting?*

5. In a criminal tax evasion prosecution based entirely on circumstantial evidence, may the trial court refuse to give the jury any instruction whatsoever to the effect that the defendant must be acquitted if the proof is not such as to exclude every reasonable hypothesis other than that of guilt?

6. May the trial court refuse to instruct the jury upon the section of the statute which forms the basis of the indictment?

## STATUTES INVOLVED

INTERNAL REVENUE CODE:

Sec. 41. *General Rule.*

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (Title 26, USC 1946 ed., Sec. 41)

Sec. 145 (b). *Penalties.*

*Failure to collect and pay over tax, or attempt to defeat or evade tax.* Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution. (Title 26 USC 1946 ed., Sec. 145 (b))

## STATEMENT

The petitioner Marion L. Holland, was indicted under Section 145 (b) of the Internal Revenue Code for willfully and knowingly attempting to evade and defeat income taxes for the years 1946 and 1947 by filing or causing to be filed false and fraudulent income tax returns (R. 7-8).

Petitioner and his wife, petitioner Ethel E. Holland, were indicted under Section 145 (b) of the Internal Revenue Code for willfully and knowingly attempting to evade and defeat income taxes for the year 1948. Petitioner Marion L. Holland was acquitted as to the years 1946 and 1947. Both petitioners were convicted on the charge that they had willfully attempted to defeat and evade income taxes for the year 1948 (R. 8-9, 12).

The nature of the Government's case was described by the Court of Appeals as follows (R. 342):

> "The returns for each of the prosecution years were prepared by a tax accountant from books and records kept by him from information furnished by appellants. There is no contention that the returns do not accurately reflect all of the income shown on the books and records maintained by the taxpayers in the course of their business as owners of a hotel and restaurant in Golden, Colorado. There is no direct proof of any specific unreported item of income or undisclosed sources of income, or that any items of expense claimed as deductions were not legitimate and allowable. The government's case rests solely on the circumstances of increased net worth established by record purchases and expenditures during the prosecution period to prove a substantial understatement of taxable income for those years."

During the years 1946, 1947 and 1948 the petitioners operated a hotel in Golden, Colorado, which was acquired by Mr. Holland on April 1, 1946.

A joint tax return was filed by Marion L. Holland and Ethel E. Holland for the year 1948, reporting income of $11,211.42, with a total tax paid thereon of $1,532.52 (R. 251). This return, as were the individual returns filed by petitioner Marion L. Holland for the years 1946 and 1947, was prepared by Dwight Dulaigh, a tax consultant, from the books and records of the petitioners which he kept (R. 152). In addition to the permanent books and records, a daily record showing disbursements and receipts in cash

and by check for the operation of the hotel was supplied to Mr. Dulaigh by the petitioners for the purpose of computing their taxable income (R. 153). Not only the permanent books and records of the petitioners, but also the daily cash reports which were prepared each day, were available to the Government during its investigation, and to the court during the trial (R. 88, 89, 159, 161). Attached to the daily report sheets were cash "paid out" slips representing receipts for whatever cash was paid out for any particular item (R. 159-161). These receipts were also available to the Government. When an expenditure was made, not by cash but by check, there was a stub and a cancelled check to show the nature of the expenditures (R. 159-161). These checks were also available to the Government (R. 159-161). The petitioners further offered the Government investigators the opportunity of standing by the cash registers and checking the gross receipts in order to determine whether or not those receipts approximated those shown during the period covered by the indictment (R. 89). The record is destitute of any evidence of any specific unreported income, of any undisclosed source of income, or of any improper or unallowable expenditure (R. 342). The record is similarly devoid of any evidence that petitioners' books and records were incomplete or inadequate for the purpose of truly reflecting taxable income on the basis of the method of accounting employed by the petitioners (R. 342). The only inaccuracy relating to petitioners' income tax returns resulted in an overstatement of petitioners' income in that they failed to claim depreciation with respect to certain items of hotel equipment and fixtures purchased between March 19, 1948, and May 12, 1948. The fact of the purchases, however, was reflected in petitioners' checks (R. 158, 160-161).

The Government's case was based entirely upon net worth computations. The Government fixed the petitioners' opening net worth on the first day of January, 1946 at $19,152.59, consisting of bank account balances in the

amount of $2,152.09, corporate stock having a cost basis of $29,650, less certain liabilities (R. 181). Based on record purchases and expenditures and starting with the figure of $19,152.59, the Government purported to show an increased net worth for the year 1946 in the amount of $54,863.09; for the year 1947 in the amount of $29,516.17; and for the year 1948, the year now involved, in the amount of $28,743.62 (R. 180-185). The indictment relating to the year 1948 charged the petitioners with understating their income for that year by approximately $18,000, resulting in an asserted unpaid tax liability of $7,518.88 (R. 342). No evidence was introduced identifying the source of the asserted increase in net worth. No evidence was introduced to prove that the asserted increase in net worth was attributable to taxable income. No evidence was introduced refuting the possibility that the asserted increase in net worth was attributable to specific non-taxable sources such as gifts, inheritance, etc.

The petitioners did not take the stand on their own behalf. They did, however, give to the Government investigator during the course of the investigation certain sworn statements in which they fixed their net worth on January 1, 1946, as $156,000 or $157,000 (R. 71-72), consisting of $104,000 in cash accumulated prior to December 22, 1933 (R. 71-72, 82, 303); $9,000 in cash accumulated subsequently from salaries (R. 71), and the balance in corporate stock (R. 71). The Government sought to meet its burden of proof by introducing evidence as to certain visible assets and liabilities on January 1, 1946, by introducing evidence of subsequent expenditures and purchases, by introducing the sworn statements above referred to, and by introducing circumstantial evidence relating to the petitioners' financial history and tending, according to the Government's theory, to show that the petitioners were in fact not affluent during the years prior to the taxable period and could not have accumulated a cash fund (R. 343-347).

In computing the petitioners' opening net worth on January 1, 1946, the Government included no part of the

$113,000 cash fund claimed by the petitioners to have existed at that time in their extra-judicial statements (R. 180-181). The only corporate stock included in the net worth of petitioners on January 1, 1946, was that stock the subsequent sale of which was reflected in petitioners' income tax return (R. 180-181, 347). No attempt was made to ascertain the separate net worth of the petitioner Ethel E. Holland on January 1, 1946.

The Government's special agent who conducted the investigation stated that the petitioner Marion L. Holland had told him that part of the cash fund which he had accumulated consisted of money obtained when he turned in about $10,000 to $20,000 in gold to various banks pursuant to the President's call. According to the Government's special agent the petitioner identified the banks by name, among which was the Colorado National Bank. The special agent stated that he did not inquire at any of these to determine whether or not gold was in fact turned in for cash by the petitioners (R. 86-87). The petitioner had further indicated to the special agent during his investigation that a large part of the cash accumulated was a result of real estate transactions in the 1920's when he was buying and selling real estate at a profit in Denver County (R. 93-94). The Government's special agent testified that he personally did not check into the records of the County Clerk and Recorder of Denver County to determine which properties were bought and sold by Mr. Holland (R. 94), and that he did not know whether anyone else had made such a check. The petitioner further had told the Government's special agent that approximately $15,000 in cash was accumulated as a result of certain restaurant sales. The special agent testified that he had made no check of the records to determine the number of sales or the selling price (R. 99).

With respect to the currency, no part of which was included by the Government in its opening net worth statement, the Government's special agent testified as follows (R. 85):

"The only question of cooperation which I have in mind was whether they always told us the truth about their currency, or not."

With respect to petitioners' security transactions, Mr. Glenn W. Davis, Cashier of the United States National Bank of Denver, testified for the Government that his bank made loans to Mr. Holland from 1942 to 1946 (R. 25); that these loans were secured by a pledge of corporate stocks (R. 26), and that at the end of the year 1945, the outstanding balance on the loans was secured by the following corporate securities (R. 26-30):

| Date of Pledge | Shares Pledged | Corporation | Record |
|---|---|---|---|
| 1- 3-42 | 300 | Southern Pacific Company | 26 |
| 5-27-42 | 200 | Midland Steel | 27 |
| 5-27-42 | 200 | Curtis Publishing Company | 27 |
| 5-27-42 | 100 | Nash-Kelvinator | 27 |
| 5-27-42 | 100 | Commercial Credit | 27 |
| 7- 3-42 | 100 | Columbia Broadcasting Company | 27 |
| 12-29-42 | 100 | Midland Steel | 27 |
| 1-25-43 | 100 | 20th Century Fox | 27 |
| 7-27-43 | 100 | Midland Steel | 27 |
| 7-27-43 | 100 | 20th Century Fox | 27 |
| 1- 6-44 | 400 | 20th Century Fox | 27 |
| 3- 6-44 | 100 | 20th Century Fox | 28 |
| 9- 5-44 | 500 | United Gas | 28 |
| 9- 5-44 | 1000 | Commonwealth & Southern | 28 |
| 10-13-44 | 50 | United Gas | 28 |
| 10-28-44 | 100 | Certainty Products | 28 |
| 11- 8-44 | 600 | Certainty Products | 28 |
| 5- 7-45 | 200 | 20th Century Fox | 28 |
| 5- 1-45 | 100 | Sinclair Oil | 28 |
| 12-14-45 | 100 | Sinclair Oil | 28 |

Mr. Elmer C. Penny, Vice-President of the Wyoming National Bank at Casper, Wyoming (R. 140-144), a Government witness, testified that his bank had made a loan to Mr. Holland, in the name of "Francis M. Monroe" on July 18, 1938, in the sum of $1,450.00 (R. 141); that the loan was secured by 200 shares of Paramount Pictures Corporation stock and 100 shares of New York Central Railroad stock (R. 141); that the loan was paid July 29, 1938 (R. 141); that a second loan was made September 6, 1938, in the sum of $1,070.92 (R. 141-142), and that this loan was secured

by 100 shares of New York Central Railroad stock (R. 141) and 100 shares of Southern Pacific Railroad stock (R. 142), and was paid September 15, 1938 (R. 142).

Mr. Robert B. Bryans, Vice-President of the Casper National Bank (R. 130-132), a Government witness, testified that his bank had made eight loans (R. 131) to Mr. Holland from September 1937 to April 1938 ranging from $200 to $2,194.38 (R. 131). All these loans were secured by stock as follows (R. 131-132):

| Date of Pledge | Shares Pledged | Corporation | Record |
|---|---|---|---|
| 9-15-37 | 50 | 20th Century Fox | 131-132 |
| 3- 7-38 | 100 | Warner Bros. | 131-132 |
| 3- 7-38 | 100 | Warner Bros. | 121-132 |
| 9-27-38 | 100 | North Central Railway | 131-132 |
| 10-15-38 | 100 | Western Union | 131-132 |
| 12-30-38 | 50 | Holly Sugar | 131-132 |
| 12-30-38 | 300 | Nash-Kelvinator | 131-132 |

Mr. George C. Bodley, the special agent of the Bureau of Internal Revenue, testified as follows (R. 95, 96):

> "Q. So that before January 1, 1946 he had bought and sold at a profit many shares of the corporate stock, is that right?
>
> A. Yes, he did. His greater purchases were still on hand in 1946. He held stock then."

The only proof in the record of the actual sale of any portion of the corporate stock owned by petitioners is reflected in Schedule "D" (R. 239) attached to the income tax return of Mr. Holland for the year 1946. It is there indicated that on February 2, 1946, blocks of 20th Century Fox Film stock and blocks of Midland Steel Products Company stock were sold for a total of $52,151.78. Schedule "D" does not recite the number of shares sold. In his extra-judicial statement petitioner Marion L. Holland asserted that he did not know whether or not he had sold all of his securities on or before the date he purchased the hotel in April, 1946 (R. 302).

With respect to the failure of the Government to account for all of the stock which its witnesses had indicated was

in existence on or at some time before January 1, 1946, the Court of Appeals stated as follows (R. 346):

> "... Subsequent returns for the period in question did not reflect the sale of any stock. If, therefore, any stocks remained unsold in 1946, they must be assumed to have remained in his custody and could therefore have no bearing on his net worth as established by purchases and expenditures."

The Government's case against petitioner Ethel E. Holland was based solely on the theory that any unreported income must have been the result of an understatement of gross receipts; that the petitioner Ethel E. Holland prepared the daily sheets showing the gross receipts and turned them over to the bookkeeper; and that, therefore, the evidence was sufficient for the jury to conclude that Mrs. Holland had violated the statute, notwithstanding the failure of the Government to demonstrate a single discrepancy in any daily report prepared by Mrs. Holland (R. 193, 198).

## SUMMARY OF ARGUMENT

1. The Government's case rested "solely on the circumstances of increased net worth" (R. 342). The petitioners' books and records were complete and were made available to the Government agents during their investigation and to the court during the trial. There was no evidence of any specific item of unreported income, of any improper deduction, of any undisclosed source of income, or of any error in the petitioners' books which would have resulted in the understatement of taxable income. The use of the net worth method was a departure from the method of computing income utilized by the petitioners. Section 41 of the Internal Revenue Code expressly limits the authority of the Government to deviate from the method of accounting selected by a taxpayer to situations where he does not keep books and records in accordance with a regular method of accounting, or where the method employed does not clearly reflect taxable income. The lower courts have almost uni-

formly taken the position that criminal prosecutions under Section 145 (b) are subject to the provisions of Section 41 of the Internal Revenue Code so that resort to the net worth method of computing income must be limited to situations where the taxpayer's books and records are inadequate. Since Section 145 (b) sets up no standard for computing the "tax imposed", and taxable income varies with the method of accounting used, reference must be made to the other provisions of the Internal Revenue Code, including Section 41, relating to the computation of the tax generally. Moreover, it would be unreasonable if the limitations relating to the use of net worth in civil cases were non-existent or less stringent in criminal prosecutions. The Government's contention that the net worth method is a method of proving understatement of income, rather than a method of accounting, is a play on words. Any method of accounting is a technique for proving or establishing income; the net worth method is distinguishable only because of its inherent crudeness. In the light of the requirements of Section 41 and the fact that the Government's case was predicated solely on net worth computations, the petitioners' motions for judgments of acquittal should have been granted.

2. In order for a net worth computation to be worthy of probative value it is necessary, first, to establish accurately the net worth starting and ending points together with any non-deductible expenditures not otherwise reflected in newly-acquired assets. If the total represented by the increase in net worth, plus other non-deductible expenditures, is in excess of the taxable income reported and if, but only if, this total is attributable to taxable income, then it reasonably follows that the taxpayer has understated his taxable income. The burden of proving whether or not increases in net worth are attributable to currently taxable sources cannot be shifted to the taxpayer by characterizing it as the burden of explanation. There is no logical justification for assuming or creating the presumption that

every asserted increase in net worth is attributable to current taxable income. If the Government's position were accepted, it would shift to the taxpayer the burden of proving the negative of the most critical element of its case—the attempted evasion of a "tax imposed".

3. The Government failed to sustain its burden of proving the net worth starting point. Moreover, its investigation was defective. Even if the petitioners' extra-judicial declarations were competent the affirmative deficiencies in the net worth starting point were of such a character as to deprive it of probative value. The Government omitted a critical item of currency despite the fact that its own witness, the special agent, expressed doubt as to the existence or non-existence of this item. The Government omitted hundreds and possibly thousands of shares of stock which its own witness showed were in existence on or prior to the net worth starting point date and which were neither reflected in the net worth computations or otherwise accounted for.

4. The extra-judicial declarations made by petitioners to Government agents were neither competent as evidence nor sufficient as proof. The declarations were not properly corroborated. The rule requiring corroboration applies not only to outright confessions but to all declarations or admissions whether inculpatory or exculpatory. Without the declarations, the Government's proof on the net worth starting point would be deprived of even the small meaning it might otherwise have had.

5. Assuming that the Government had proven the net worth starting point with sufficient accuracy, it completely failed to prove an understatement of taxable income. There was no proof of any specific unreported item of income, any improper deduction, or of any undisclosed source of income. There was no proof of the sources of the asserted increases in net worth. There was not even any evidence introduced to refute the possibility that the increases were

attributable to specific non taxable sources such as gifts or inheritance. The jury was improperly allowed to assume that increases in net worth were attributable to currently taxable income.

6. Even assuming that the Government succeeded in proving an understatement of taxable income, there was not one item of evidence on the element of willfulness. While it may be proven by either circumstantial or direct evidence, willfulness cannot be presumed or inferred from a mere understatement of income. There must be specific independent evidence, such as the keeping of a double set of books, the making of false entries, the destruction of books or records, the concealment of assets or some similar form of conduct to justify a conviction under Section 145 (b). No such evidence existed here. A pure net worth case will never justify submission to the jury for this reason alone.

7. The trial court's rulings on the granting and denial of instructions were either erroneous or misleading. It refused to instruct the jury on the basic requirements of a net worth prosecution. It refused to instruct the jury on the quality and nature of circumstantial evidence. It refused to instruct the jury on the statutory basis of the offense charged. It improperly limited the Government's burden of proof and shifted the burden to the petitioners. Its instruction on reasonable doubt was erroneous.

## ARGUMENT

### I.

### RESORT TO THE NET WORTH METHOD OF COMPUTATION WAS NOT PERMISSIBLE; AND SINCE THE GOVERNMENT'S CASE RESTED SOLELY ON THE CIRCUMSTANCES OF INCREASED NET WORTH, PETITIONERS' MOTIONS FOR JUDGMENTS OF ACQUITTAL SHOULD HAVE BEEN GRANTED

The nature of the present case, and particularly the evidence upon which the prosecution was based, was accurately described by the Court of Appeals as follows (R. 342):

> "The returns for each of the prosecution years were prepared by a tax accountant from books and records kept by him from information furnished by appellants. There is no contention that the returns do not accurately reflect all of the income shown on the books and records maintained by the taxpayers in the course of their business as owners of a hotel and restaurant in Golden, Colorado. There is no direct proof of any specific unreported item of income or undisclosed sources of income, or that any items of expense claimed as deductions were not legitimate and allowable. The government's case rests solely on the circumstances of increased net worth established by record purchases and expenditures during the prosecution period to prove a substantial understatement of taxable income for those years."

The record affirmatively demonstrated that all of the permanent books and records of the petitioners were in existence and were made available to the Government during its investigation and to the court during the trial (R. 88, 89, 153, 159, 161). In addition to these permanent records the petitioners made available the daily reports for the entire period covered by the indictments showing the daily receipts and disbursements, both in cash and by check. Attached to each daily report were cash "paid out" slips for each item for which cash was paid (R. 159-161). The petitioners' checks were also made available (R. 159-161). The petitioners further offered the Government investigators the opportunity of standing by the cash registers and checking the gross receipts in order to determine whether or not those receipts approximated those shown during the period covered by the indictment (R. 89). Not a single error or discrepancy was found or proven of a character which would have resulted in the understatement of taxable income. There was no evidence of any specific item of unreported income, of any improper deduction or of any undisclosed source of income (R. 342). The Government's case was, as the appellate court stated, predicated "solely on the circumstances of increased net worth" (R. 342).

This being so, it was incumbent upon the trial court to grant the petitioners' motions for judgments of acquittal.

No specific statutory basis exists for the use of the so-called net worth expenditures method of computing income. Section 41 of the Internal Revenue Code expressly limits the authority of the Government to deviate from the method of accounting selected by the taxpayer to situations where the taxpayer does not keep books and records in accordance with a regular method of accounting, or where the method employed does not clearly reflect taxable income. The lower courts appear to be almost uniform in either holding expressly or assuming that resort to the net worth method of computing income in civil and criminal cases is inappropriate absent independent evidence that the taxpayer's books and records are inadequate or substantially inaccurate.

Moreover it is impossible to apply Section 145(b) without reference to those other provisions of the Code, including Section 41, which relate to the computation of the taxpayer's income and tax. Section 145(b) makes unlawful a wiilful attempt to evade and defeat "any tax imposed by this Chapter" but it sets forth no method for determining the "tax imposed". Furthermore, the taxing statutes do not purport to establish a concept of invariable taxable income but rather are premised on the fact that the amount of the tax will vary with the accounting method utilized to establish the taxpayer's income. It follows therefore that reference must be had to those other sections of the Code pertaining to computation of tax in order to determine whether the taxpayer's income as reported was in fact understated. In any event, it would be extraordinary if the limitations imposed under Section 41 for the purpose of computing civil liability were non-existent or less stringent in the case of criminal prosecutions.[1]

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[1] The danger can be illustrated simply. The Government would undoubtedly concede that taxable income may vary substantially according to the method of accounting used, despite the fact that

That prosecutions under Section 145 (b) are subject to the limitations of Section 41 of the Internal Revenue Code so that inadequacy or inaccuracy of the taxpayer's books and records is prerequisite to use of the net worth method finds consistent support in the language of the Courts of Appeals. Thus the Court of Appeals for the Ninth Circuit, in *Remmer* v. *United States*, 205 F. 2d 277, 286, judgment vacated and case remanded for hearing without considering the point, 347 U.S. 227, stated expressly that—

> "The net worth method of computing income may be used only where a taxpayer does not keep books or such books are inadequate in that they do not clearly reflect income."

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there have been no improper omissions of income or improper deductions. Therefore, if resort to net worth computations is permitted where there is no evidence whatsoever of fraud and of the taxpayer's failure to reflect any specific items of income in his books and records, a substantial understatement of income may be proved in a criminal prosecution and yet be solely attributable to the variance in method used in computing or proving income. Thus one of the critical elements of proof, may be established solely by resort to the net worth method, rather than the method of accounting utilized by the taxpayer. The danger is magnified when the requirements of proof as to the other elements are considered. In construing Section 145(b) it is commonly recognized that the Government need not prove the exact amount of tax evaded and that, under ordinary circumstances, an additional tax follows as a matter of law from an understatement of taxable income. *United States* v. *Johnson*, 319 U. S. 503, 517; *United States* v. *Rosenblum*, 176 F. 2d 321 (CA 7); *United States* v. *Schenck*, 126 F. 2d 702 (CA 2); *Gleckman* v. *United States*, 80 F. 2d 394 (CA 8). With respect to the question of willful intent, where, as here, the Government's case is predicated "solely on the circumstances of increased net worth" (R. 342), if the case is submitted to a jury the intent will have to be inferred from the understatement of income, notwithstanding that as a matter of law such inference is not permissible. *Spies* v. *United States*, 317 U. S. 492; *United States* v. *Murdock*, 290 U. S. 389; *Wardlaw* v. *United States*, 203 F. 2d 884 (CA 5); *United States* v. *Martell*, 199 F. 2d 670 (CA 3); *Lurding* v. *United States*, 194 F. 2d 419 (CA 6); *Stinnett* v. *United States*, 173 F. 2d 129 (CA 5); *Haigler* v. *United States*, 172 F. 2d 986 (CA 10); *Jones* v. *United States*, 164 F. 2d 398 (CA 5); *Malone* v. *United States*, 94 F. 2d 281 (CA 7); *Hargrove* v. *United States*, 67 F. 2d 820 (CA 5); *United States* v. *Wilbur L. Clark* (S. D. Cal., August 4, 1954), not yet reported.

See also *Olender* v. *United States*, 210 F. 2d 795, 798 (CA 9). The Court of Appeals for the Fifth Circuit has consistently taken the same position. Thus, in *Sasser* v. *United States*, 208 F. 2d 535, 537, it stated:

> ". . . The net worth method of reconstructing taxable income *in cases where the taxpayer has no records from which his actual income may be computed* is a hybrid method of determining income based upon the cost of assets owned by the taxpayer at the beginning and at the end of each taxable period." (Emphasis added.)

See also *Bryan* v. *Commissioner of Internal Revenue*, 209 F. 2d 822, 826, 827 (CA 5). The Court of Appeals for the Third Circuit is also of the opinion that resort to net worth computations is subject to the limitations of Section 41. In *United States* v. *Williams*, 208 F. 2d 437, 437-438, the Court stated:

> "The government's case was based upon a comparison between the net worth of the taxpayer at the beginning and at the end of the two taxable periods above mentioned. *The defendant contends that his is not a proper case for the application of the net worth formula for proving tax evasion. In this he is wrong. The statute* [I.R.C. § 41] *provides that if the taxpayer has no regular method of accounting 'the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.'* This taxpayer by his own admission kept no regular books at all. He did have receipts for some items claimed as deductions. He said that his business was that of leasing real estate. But there was one good-sized item which he admitted receiving from a gambling establishment for which he accounted only by saying it was included in what he returned as rental from the property in which the establishment was located. There were other items which he said were not income." (Emphasis added.)

To the same effect are the decisions of the Court of Appeals for the Fourth Circuit. See *Dawley* v. *United States*, 186

F. 2d 978, 980, and *Bell* v. *United States*, 185 F. 2d 302, 308, certiorari denied 340 U. S. 930, where the Court stated:

> "... An estimate of the taxpayer's net worth as the means of determining his income *is resorted to in the absence of accurate records* which it is his duty under the statute to make and to preserve, ..." (Emphasis added.)

The Court of Appeals for the Sixth Circuit has indicated a similar understanding of the law in *Gariepy* v. *United States*, 189 F. 2d 459, 461, where it stated:

> "... *When investigation was begun by agents of the Treasury, they were unable to find adequate records disclosing receipts of income by the appellant. The investigators then undertook to establish his income by the so-called 'net worth' method.* This involved fixing a base from which increases in the taxpayer's assets could be estimated by examination of bank accounts, real estate records, showing investments, the books of stockbrokers indicating purchase of securities, and so on. This method of determining the liability of a taxpayer (either civil or criminal) is an established practice of the government and has received the sanction of courts in many cases. *It is now too late for a taxpayer who fails to keep or preserve records to complain.*" (Emphasis added.)

It is interesting to note that in *Friedberg* v. *United States*, 207 F. 2d 777 (CA 6), certiorari granted, 347 U. S. 1006, the trial court instructed the jury as follows:

> "In this case the government is trying to establish an additional tax owing by a method known as the net worth method, which method is authorized where the bookkeeping methods of the defendant to not clearly reflect the income of the defendant. *If you find that the taxpayer's bookkeeping methods do clearly reflect his income, then the government has no right to use the so called net worth method and your verdict must be for the defendant in this case as to all counts of the indictment.*"[2] (Emphasis added.)

[2] Pages 1138-1139 of the Record in *Friedberg* v. *United States*.

A most forceful expression of the view which the petitioners now urge upon this Court was set forth by District Judge Hutcheson in granting the defendant's motion for a judgment of acquittal on April 22, 1954, in *United States* v. *Riganto*, 121 F. Supp. 158, 161, 162 (E. D. Va.):

> "*. . . I have heretofore ruled, and I adhere to that ruling, that the burden is upon the Government to show, before resorting to another method, the inadequacy of the books and records employed by the taxpayer. The Government must also show that the net worth method, the bank deposits method, or whatever other method is adopted, does reasonably reflect the income of the taxpayer. In meeting that burden, the Government must introduce evidence, other than its own computations, to discredit the books and records of the taxpayer, such as proof of unrecorded transactions, or internal evidence within the books themselves showing incompleteness or inaccuracy.* (Emphasis added.)
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> • • •
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> "Unless the Government proves the necessity for exercising a discretion in resorting to such method and then submits sufficient proof to show that the method reasonably and accurately reflects the income of the taxpayer, the duty is upon the Court to grant a motion for udgment of acquittal and I shall do so in this case."

The position taken by the petitioners here appears to have been adopted by the Tax Court which, in *Glackman* v. *Commissioner*, 10 T. C. M. 1132, 1951, after citing cases holding that there may be resort to net worth method where the taxpayer fails to produce adequate records, made the following statement:

> "This case, however, differs from those cases and others in which the increase in the use of net worth has been sustained. In this case, the petitioner's principal source of income was from sales at his barroom. As to those sales, he had records and the respondent did not find error in them in determining the deficiency, nor through any evidence at the trial, although there was considerable examination of witnesses as to the accuracy of the records."

See, also, *Thomas A. Talley*, v. *Commissioner*, Tax Court Docket Nos. 33,140 and 33,141, June 30, 1953, 20 T. C. No. 101, where the Tax Court said:

> "The limitations of the increase in net worth method are well known. Often it results in an inaccurate statement of income or the placing of income in the wrong year and, at best, it yields only an approximation. . . .
>
> "The ordinary method of computing taxable income in accordance with the general pattern of the code is to subtract allowable deductions from a taxpayer's gross income. The increase in net worth method is, of course, not in accord with this statutory pattern and is permitted by virtue of Section 41, I. R. C., only in unusual circumstances, none of which is present here."

The Government's position in respect to the present contention is that Section 41 has no application to the proof of a criminal tax evasion case, the net worth method being not a method of accounting but of "proving . . . that there is a substantial understatement in the taxpayer's reported income and tax." (Brief for the United States in *Remmer* v. *United States*, p. 49). This argument will not withstand analysis. Calling net worth a method of proof rather than a method of accounting is simply playing with words. Every method of accounting is a method of proving or establishing the taxpayer's income for the purpose of computing the tax due. The net worth method is utilized for precisely this purpose. If what the Government means is that the more conventional methods of accounting are more accurate and precise than the net worth method, then the petitioners will agree. Indeed the only distinction of the net worth method is its inherent crudeness.

The Government itself has gone far toward conceding the correctness of petitioners' position when in its petition for certiorari in *Calderon* v. *United States*, 207 F. 2d 377 (CA 9), certiorari granted 347 U. S. 1008, it made the following statement (p. 6):

> "As this Court stated in *United States* v. *Johnson*, 319 U. S. 503, 517, in tax evasion cases *where the de-*

> *fendant has engaged in multitudinous financial transactions of which he kept no adequate records*, it is not to be expected that understatement of income can be shown by direct proof of the individual income-producing transactions. *In such cases the customary method of proof consists in showing an increase in the defendant's net worth* during the year substantially in excess of his reported income plus non-income receipts like gifts and bequests."[2] (Emphasis added.)

In this light, the Government is hardly in position to contend that resort to net worth computations as the sole evidence to support a tax evasion prosecution can be justified in situations where the taxpayer's books and records are complete and concededly do not contain a single error which would result in the understatement of taxable income.[4]

## II.

## SINCE THE GOVERNMENT FAILED TO ESTABLISH A PRIMA FACIE CASE, PETITIONERS' MOTIONS FOR JUDGMENTS OF ACQUITTAL SHOULD HAVE BEEN GRANTED.

### A. Burden of Proof—General Principles.

Before proceeding to test the sufficiency of the Government's case, on the assumption that resort to net worth was appropriate, it may be helpful to analyze the theory and application of the net worth method in terms of the applicable principles of law, particularly those relating to the burden of proof. The net worth technique is designed to establish that the taxpayer's acquisitions and expendi-

[2] It is the petitioners' position that net worth computations have been approved by this Court for "reinforcement" purposes only. *United States* v. *Johnson*, 319 U. S. 503.

[4] In the brief in opposition to the petition in this case the Government correctly stated that the precise point here raised (Heading No. I) had not been raised before the lower courts (Brief in Opposition, p. 13). The petitioners, however, did move for a judgment of acquittal on the ground of insufficiency of evidence (R. 170-171). Assuming the correctness of the petitioners' contention, there was no evidence whatsoever to properly submit to the jury in proof of a violation of Section 145 (b). This being so, it would be difficult to conceive of an error more plain and substantial or more likely to result in a miscarriage of justice.

tures during the taxable period exceed the income reported and that such acquisitions and expenditures are attributable to currently taxable income. If the circumstances relating to the net worth computations prove any less, no inference of understatement of taxable income can be drawn. In order for a net worth computation to be worthy of probative value it is necessary, first, to establish accurately the net worth starting and ending points together with any non-deductible expenditures not otherwise reflected in newly-acquired assets. If the total represented by the increase in net worth, plus other non-deductible expenditures, is in excess of the taxable income reported and if, but only if, this total is attributable to income which is currently taxable, then it would follow that the taxpayer has understated his taxable income. Unless the net worth starting point is accurately established, a net worth computation will have no probative value for there will be no way of determining that expenditures and acquisitions made during the taxable period were not attributable to assets or funds acquired prior to the net worth staring point. On the other hand, even if the net worth starting point is definitely established so that expenditures and acquisitions during the taxable period can be assumed to have been made out of current sources, the computation will be insufficient to prove an understatement of taxable income unless the sources represent currently taxable income.

The peril involved in relying upon net worth computations as the sole proof in a tax evasion prosecution is substantially magnified by the manner in which they are applied. The Government commonly assumes the non-existence of all assets except those which are visible to its investigators. Non-visible assets such as currency are eliminated unless the taxpayer assumes the burden of establishing their existence. Having predicated a starting point upon assumption, the Government then assumes that increases over the net worth at the starting point are attributable to taxable income. This assumption is often made without even an attempt to identify the source of the funds utilized by the taxpayer. The taxpayer is thus

forced to prove that the acquisitions and expenditures are attributable to non-taxable sources or to sources which are not taxable during the year in question. Accordingly, the burden is shifted to the taxpayer to prove that he did not in fact understate his taxable income, thereby evading or avoiding a "tax imposed".

The lower courts are in general agreement that, unless the starting point is accurately established, net worth computations are entirely lacking in probative value.[5] As stated by the Court of Appeals for the Seventh Circuit in *United States* v. *Fenwick*, 177 F. 2d 488, 492 (CA 7):

> "Remembering that the government has the burden of proof in a criminal case, that the burden never shifts to defendant, that circumstantial evidence must be of such character as to exclude every reasonable hypothesis except that of guilt, it necessarily follows that, when the government relies upon circumstances of increased net worth and expenditures in excess of reported income to establish income tax evasion, the basic net worth must be established. The defendant is not compelled to take the witness stand; he is not compelled to make proof that he is innocent, but he must be proved guilty by the evidence beyond all reasonable doubt, and where there is uncertainty as to whether all the assets of defendant are included in the government's computation of net worth, it follows that its computations can not be relied on. Essential proof of no other assets is the cornerstone of the evidence of the government; that cornerstone being faulty, the whole edifice is so weakened as to be undependable as proof of guilt beyond all reasonable doubt."

See also, to the same effect, *Olender* v. *United States*, 210 F. 2d 795 (CA 9);[6] *Ford* v. *United States*, 210 F. 2d

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[5] In the present case, however, the trial court erroneously refused to instruct that the Government must prove the net worth starting point with accuracy. See discussion under Heading No. III, *infra*.

[6] In *United States* v. *Riganto*, 121 F. Supp. 158 (E. D. Va.), Judge Hutcheson made the following comments:

> ". . . In the last few years I have observed with interest a change that has taken place in the nature of proof offered to

313 (CA 5); *Calderon* v. *United States*, 207 F. 2d 377 (CA 9), certiorari granted 317 U. S. 1008; *United States* v. *Venuto*, 182 F. 2d 519 (CA 3); *Bryan* v. *United States*, 175 F. 2d 223 (CA 5), affirmed without considering the point 338 U. S. 552.

While the principle that the net worth starting point must be definitely established has been almost uniformly accepted, a few lower courts have concurred in the Government's position that increases in net worth must be assumed to be attributable to currently taxable income, unless the taxpayer demonstrates the contrary. However, the assumption has almost always been made in cases where the net worth computations were used to corroborate specific evidence of understatement of taxable income, or,

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support the charge of the prosecution in many of these cases charging tax fraud. This change has caused me some concern by what appears to be a preference to introduce proof to show understatement of income and fraudulent intent by methods other than by direct evidence. Of course, it is necessary in some cases that the Government proceed by indirect methods. This evidence consists of proof undertaking to show income of the taxpayer computed upon what is referred to as the net worth increase or bank deposits and expenditures methods or a combination of both. The latter is employed here. Basing my observation upon a number of cases during the past few years, it would seem that the use of one or both of these methods has been employed through preference at times when direct evidence is available.

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"It may sound plausible to contend that the taxpayer knows better than the Government the assets owned at a particular time and the amount of his income for a given period, but this is to ignore the important rule of law concerning the burden of proof.

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". . . It is evident from the testimony in this case there was not a proper starting point insofar as the bank deposits and expenditures method is concerned. If, in such circumstances, the case should be submitted to the jury and they should, by possible chance, arrive at a verdict of guilty, they could do so only upon conjecture, theory or speculation. When such circumstances exist, it is the duty of the trial court, when an issue of this kind is made up by motion, to sustain the motion."

at the minimum, in cases where an undisclosed source of taxable income was discovered[7] See, for example, *United States* v. *Johnson*, 319 U. S. 503; *Smith* v. *United States*, 210 F. 2d 496 (CA 1), certiorari granted 347 U. S. 1010; *Mitchell* v. *United States*, 208 F. 2d 854 (CA 8); *Davena* v. *United States*, 198 F. 2d 230 (CA 9); *Gendelman* v. *United States*, 191 F. 2d 993 (CA 9); *Bell* v. *United States*, 185 F. 2d 302 (CA 4), certiorari denied 340 U. S. 930; *United States* v. *Vassallo*, 181 F. 2d 1006 (CA 3); *Lurding* v. *United States*, 179 F. 2d 419 (C.A. 6); *United States* v. *Hornstein*, 176 F. 2d 217 (CA 7); *Schuermann* v. *United States*, 174 F. 2d 397 (CA 8), certiorari denied 338 U. S. 831; *United States* v. *Potson*, 171 F. 2d 435 (CA 7); *United States* v. *Skidmore*, 123 F. 2d 604 (CA 7), certiorari denied 315 U. S. 800; *Malone* v. *United States*, 94 F. 2d 281 (CA 7); *Gleckman* v. *United States*, 80 F. 2d 394 (CA 8). The unwarranted nature of the assumption and its irreconcil-

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[7] The position taken by the Government in its brief (p. 31) presented to the Courts of Appeals for the First Circuit in *Smith* v. *United States*, 210 F. 2d 496, is most revealing in respect to this question:

> ". . . This inference, [of understatement of income] in turn, may be drawn by a jury only if two conditions obtain: (1) that there is evidence of a *possible source* (Emphasis added) of income to account for the expenditure or increases in net worth, which evidence serves to *eliminate the possibility* (Emphasis added) that the expenditures or increases in net worth were attributable to non-taxable sources, such as gifts or inheritances; and (2) that there is a fixed starting *point*, that is, a date coinciding with the beginning of the first prosecution year at which time the taxpayer's net worth can be affirmatively established with some definiteness, which, in turn, serves to foreclose the hypothesis that the expenditures or net worth increases derived from prior accumulated funds."

It is the petitioners' position that even under the standards set forth as requisites for the inference in the Government's brief in the *Smith* case, *supra*, no basis for the inference existed in this case; although petitioners do consider novel the Government's statement that evidence of a possible source of income to account for increases in net worth serves to eliminate the possibility that the expenditures or increases in net worth are attributable to non-taxable sources.

ability with established principles of burden of proof in criminal cases has been the subject of recent judicial notice and criticism. Thus the Court of Appeals for the Third Circuit, in *United States* v. *Caserta*, 199 F. 2d 905, 907, recently observed:

> ". . . Of course it is necessary, so far as possible to negative nontaxable receipts by the taxpayer during the period in question. The cases show, however, a rather surprising rule that when the discrepancy between increased net worth and reported income is shown, the burden of explanation shifts to the taxpayer, at the same time repeating the usual criminal law rule that the burden throughout a criminal case is upon the prosecution. We do not, however, get into this particular ramification in the case under discussion, for the prosecutor offered proof negativing receipts for nontaxable sources such as gifts, inheritance and so on."

Similar notice of this departure from the established rule of proof was taken in *Demetree* v. *United States*, 207 F. 2d 892, 894 (CA 5), where the Court of Appeals stated:

> ". . . Further and more prejudicial to a defendant, there has grown up a kind of ancillary theory that the government, by introducing proof of deposits, expenditures, etc., having put up what it calls a *prima facie* case, the defendant finds himself jockeyed out of the position the law affords him, of insisting that the government establish his guilt by legal and credible evidence beyond a reasonable doubt. This is accomplished by requiring him to prove himself innocent by assuming the burden of overcoming the prejudicial effect of the mass of exhibits, estimates, conjectures, and conclusions which the government has been allowed to get into the record, upon the apparent theory that it is up to the defendant to explain all of it away as part of his burden to prove his innocence."

The correct rule to be applied in net worth cases was stated by the Court of Appeals for the Ninth Circuit, in *Olender* v. *United States*, 210 F. 2d 795, 807:

"... This method of proof requires the government to show the net worth of the taxpayer as of the beginning and the end of the taxable year and the non-deductible expenditures made by him that year. *If the increase in his net worth plus his non-deductible expenditures exceed his reported income for the year, and such excess is not attributable to gifts, devises, loans or other non-taxable receipts, then the conclusion may be drawn that the taxpayer* realized income which he failed to report. . . .

* * *

"... In these net worth-expenditures cases, based as they are upon an elaborate scheme of circumstantial evidence, *it is particularly important to keep the jury's attention riveted upon the ultimate question whether the government has sustained its burden of proving the crime charged beyond a reasonable doubt.* See Demetree v. United States, 5 Cir., 207 F. 2d 892; Lurding v. United States, 6 Cir., 179 F. 2d 419, 422." (Emphasis added.)

To the same effect is the forceful statement of the Court of Appeals for the Fifth Circuit, in *Ford* v. *United States*, 210 F. 2d 313, 315:

"... One of the most difficult matters of proof in such cases is to establish a satisfactory starting point at the beginning of the first of the tax periods included in the indictment, that is as applied to the present case, to negative the existence on January 1, 1945, of resources available to the defendant and his wife from which the excessive expenditures might have come. *The Government then has the further burden in such cases of proving that there were no gifts, devises, or other nontaxable income which could have been used for the expenditures, and of proving large cash expenditures within each of the tax years considerably exceeding the taxpayer's accumulated cash resources plus reported income and which expenditures could not be otherwise accounted for than by finding that the taxpayer had received more taxable income than had been reported, and had willfully and knowingly filed or caused to be filed a false and fraudulent income tax return.*" (Emphasis added.)

Two very recent decisions sustaining tax evasion convictions over defendants' objections that the Government had failed to carry the burden of proof give vigorous support to the proposition that at the very minimum the Government must establish unreported income. Thus, in *United States* v. *Stayback*, 212 F. 2d 313, 317, petition for certiorari filed May 21, 1954, No. 781, the Court of Appeals for the Third Circuit stated:

> "It is well settled that once the government *establishes unreported income* (Emphasis added) of the defendant and allows deductions claimed by him in his tax return and others that it can calculate without his assistance, the burden is on the defendant to prove that he had other allowable deductions which were not shown in his return: United States v. Smith, 3 Cir., 1953, 206 F. 2d 905; United States v. Link, 3 Cir., 1953, 202 F. 2d 592; United States v. Hornstein, 7 Cir., 1949, 176 F. 2d 217. The government is not required to prove the negative, *i.e.*, that the defendant did *not* have any other deductions. Gariepy v. United States, 6 Cir., 1951, 189 F. 2d 459."

Again, in *United States* v. *Smith*, 206 F. 2d 905, 911 (CA 3), the same court stated:

> ". . . *We think it part of the Government's prima facie case to establish, at least, that what it charges against defendant is income for the year involved.* It has not established its *prima facie* case by showing that defendant has some money and then asking the jury to infer that that money is 'income' for the year involved." (Emphasis added.)

The convenient substitution of assumption for proof in net worth criminal cases has been justified by the Government and some courts on the theory, set forth in *Rossi* v. *United States*, 289 U. S. 89, 91-92, that "it is not incumbent on the prosecution to adduce positive evidence to support a negative averment the truth of which is fairly indicated by established circumstances and which if untrue could readily be disproved by the production of documents or

other evidence probably within the defendant's possession or control." Scrutiny of the *Rossi* case, however, demonstrates its inapplicability to cases of this kind. In *Rossi, supra*, p. 91, this Court held that since "It was impossible . . . lawfully to register the still or to give the required bond . . . proof of the custody or control of a still for unlawful distillation of alcoholic spirits is enough to give rise to an inference of lack of registration and failure to give bond which the defendant must overcome by proof." The Government was thus not required to prove that the defendants did not do something which, as a matter of law, they could not have done. But here there is no logical justification for shifting the Government's burden on the most critical element of its case—the understatement of *taxable* income and the attempted evasion of a "*tax imposed*".[8] Neither logic nor experience support the assumption that newly acquired funds or assets are necessarily derived from taxable income. The sources of non-taxable receipts are numerous. There are hundreds of reported decisions involving complex litigation over the issue of whether or not receipts of one kind or another were taxable income or, if taxable, when the impact of the tax occurred. Nevertheless, the Government would have the courts speculate that every increase in net worth is attributable to income which is taxable during the year involved, without even identifying the source. This shifting of the burden of proof on the theory that it is only the burden of explanation has been recently criticized in the New York University Tax Law Review:

> "Despite the supposedly more severe standards of proof applicable to criminal proceedings, the growing

[8] The basic defect in the Government's position in its net worth proof is pointed up by the comments of the trial court, which, in connection with a hypothetical question, made the following observation (R. 167):

> "I don't believe you have assumed all the factors you need. A man could have a very large amount of interest on tax free bonds and not be liable to any federal income tax liability."

> tendency of permitting cases to go to the jury with essential elements unproved, on the theory that the burden of moving forward with evidence has shifted once the Government proves its case with some degree of probability, permits conviction on evidence which would not result in a finding of civil fraud. Tax Court judges, on the whole, have shown a commendable restraint and prudence in their findings which cannot be expected from jurors swayed by less restrained prosecutors and even, perhaps, by district judges." (Income Tax Penalties, by Emanuel L. Gordon, N. Y. Univ. Tax Law Review, Vol. 5, p. 196).

At the heart of the Government's position is the theme that it is necessary to ease the Government's burden of proof in criminal tax cases predicated on net worth computation. But, "Difficulty of proof is no substitute for actuality of proof." *United States* v. *Buchalter, et al.*, 88 F. 2d 625, 626 (CA 2). Easing the Government's burden of proof is less important than preserving basic rights of defendants. It is certainly clear that where the Government with vast investigative resources at its disposal is unable to prove a single item of unreported income or to demonstrate an undisclosed source of income, the probabilities of innocence are much greater than where the Government has secured direct evidence of fraud. If the Government's burden of proof is eased to the extent that it desires in these cases, the probabilities of convicting innocent people will be greatly enhanced. As this Court said in *Tot* v. *United States*, 319 U. S. 463, 469-470:

> "Nor can the fact that the defendant has the better means of information, standing alone, justify the creation of such a presumption. In every criminal case the defendant has at least an equal familiarity with the facts and in most a greater familiarity with them than the prosecution. It might, therefore, be argued that to place upon all defendants in criminal cases the burden of going forward with the evidence would be proper. But the argument proves too much. If it were sound, the legislature might validly command that the finding of an indictment, or mere proof of

the identity of the accused, should create a presumption of the existence of all the facts essential to guilt. This is not permissible.

* * *

". . . It would, therefore, be a convenience to the Government to rely upon the presumption and cast on the defendants the burden of coming forward with evidence to rebut it. But, as we have shown, it is not permissible thus to shift the burden by arbitrarily making one fact, which has no relevance to guilt of the offense, the occasion of casting on the defendant the obligation of exculpation. The argument from convenience is admissible only where the inference is a permissible one, where the defendant has more convenient access to the proof, and where requiring him to go forward with proof will not subject him to unfairness or hardship."

See also, *Morrison* v. *California*, 291 U. S. 82; *Oleader* v. *United States*, 210 F. 2d 795 (CA 9); *Kirsch* v. *United States*, 174 F. 2d 595 (CA 8); *Nicola* v. *United States*, 72 F. 2d 780 (CA 3).

Moreover, a conviction under Section 145 (b) requires a proof of a specific willful intent—an intent which though it may be established by circumstantial as well as direct evidence cannot be presumed from the understatement of income but must be proven by specific independent evidence. As stated in *Harding* v. *United States*, 179 F. 2d 419, 422 (CA 6):

". . . Such filing is unlawful however only if made wilfully, with knowledge of its falseness and with intent to evade taxes. There is no presumption that may be drawn from the act itself—both knowledge and wilfulness must be established by independent proof, direct or circumstantial."

Where the court proceeds to submit to a jury a Section 145 (b) case predicated solely on the circumstances of increased net worth, the issue of intent is effectively eliminated in contravention of the decisions of this Court in

*Spies* v. *United States*, 317 U. S. 492 and *United States* v. *Murdock*, 290 U. S. 389; as well as decisions of the Courts of Appeals for the Third, Fourth, Fifth, Sixth, Seventh and Tenth Circuits. *United States* v. *Martell*, 199 F. 2d 670 (CA 3); *Stinnett* v. *United States*, 173 F. 2d 129 (CA 4); *Wardlaw* v. *United States*, 203 F. 2d 884 (CA 5); *Jones* v. *United States*, 164 F. 2d 398 (CA 5); *Hargrove* v. *United States*, 67 F. 2d 820 (CA 5); *Lurding* v. *United States*, 179 F. 2d 419 (CA 6); *Malone* v. *United States*, 94 F. 2d 281 (CA 7); *Haigler* v. *United States*, 172 F. 2d 986 (CA 10).

### B. Burden of Proof—Evidence.

#### 1. Net Worth Starting Point.

The Government completely failed to sustain its burden of proving the petitioners' net worth on the starting point date. The Government fixed the petitioners' net worth as of January 1, 1946, at $19,152.59, from which it purported to demonstrate unaccounted for increases in net worth for the years 1946, 1947, and 1948. The figure of $19,152.59 admittedly included only those corporate stocks, the subsequent sale of which was reflected in petitioners' income tax returns (R. 180-181, 187-190, 346-347). In fixing petitioners' opening net worth on January 1, 1946, the only cash included by the Government as an asset was the sum of $2,153.09, consisting of balances in two bank accounts (R. 181). In the petitioners' extra-judicial statements made to the special agent of the Bureau of Internal Revenue, they claimed to have had on January 1, 1946, approximately $113,000 in currency (R. 71-73). The lower courts, as well as the Government, took the view that "the ultimate and precise issue" was whether the jury believed beyond a reasonable doubt "that there was no such fund in existence on January 1, 1946" (R. 350). According to the Court of Appeals the petitioners' "Guilt or innocence turned on a resolution of those issues [relating to the cash fund]" (R. 350). Notwithstanding this, the special agent for the Bureau of Internal Revenue—the chief Government

witness—testified with respect to the petitioners' currency as follows (R. 85):

> "The only question of cooperation which I have in my mind was whether they always told us the truth about their currency, *or not.*" (Emphasis added.)

In view of the doubt specifically expressed by this witness with respect to this critical item, it is apparent that the Government failed to sustain the burden of proving the petitioners' net worth staring point with reasonable definiteness. With respect to this item of currency the present case is similar to *Bryan* v. *United States*, 175 F. 2d 223, 226 (CA 5) affirmed 338 U. S. 552, where the Court of Appeals, in reversing a net worth conviction, observed:

> "But we cannot escape the fact that Mr. Marquis, the auditor, frankly admitted that he did not know whether his computation contained all the assets of the Defendant *or not.*" (Emphasis added.)

Furthermore, the evidence produced by the Government's witnesses clearly established that either on or before January 1, 1946, the petitioner Marion L. Holland was the owner of hundreds and possibly thousands of shares of stock (R. 29-30, 130-132, 141-142). With respect to this stock, the special agent of the Bureau of Internal Revenue testified that the petitioners' "greater purchases were still on hand in 1946" (R. 95). Having proven through its own witnesses the existence of these securities on or before January 1, 1946, the Government completely failed to take into consideration any securities except those the disposition of which was reflected in the petitioners' income tax return for the year 1946 (R. 239, 347). The court below attempted to meet this obvious defect by making the following observation (R. 346):

> ". . . The representative of the bank where the stocks were pledged for loans testified that all the stock pledged for collateral was liquidated or withdrawn early in 1946, and thereafter all other loans were se-

> cured by deeds of trust. Subsequent returns for the period in question did not reflect the sale of any stock. If, therefore, any stocks remained unsold in 1946, they must be assumed to have remained in his custody and could therefore have no bearing on his net worth as established by purchases and expenditures."

In thus disposing of the petitioners' contention the court below ignored the principle that the Government must prove the opening net worth with reasonable certainty. Certainly the fact that the stock was liquidated or *withdrawn* does not establish its non-existence on January 1, 1946. Nor is there any basis for the court's critical assumption that any stock which had not been sold prior to 1946 necessarily remained in the petitioners' custody and had "no bearing on his net worth" (R. 346). Unless a gain was realized on a subsequent disposition of the stock no duty would have been imposed upon the petitioner to report the transaction on his income tax return. Moreover, the stock could have served as collateral for the borrowing of additional funds. The important consideration, however, is that the court below found it necessary to fill in an obvious gap in the Government's case by speculating as to the possible subsequent disposition of securities which were proven to have existed on or before January 1, 1946, and which were neither accounted for by the Government nor taken into consideration in the net worth statement. With respect to these securities the present case is similar to *United States* v. *Fenwick*, 177 F. 2d 488, 491 (CA 7), where the Court of Appeals, in reversing a net worth conviction, observed:

> ". . . The agent testified that defendant had certain corporate stock but the prosecution offered no proof as to the amount owned by defendant in 1942 or whether any part or all of it was sold in 1943 or in 1944."

Another critical deficiency in the Government's case was its failure to negative in any way the possible existence of a separate estate for the petitioner Ethel E. Holland.

The evidence also established that the Government's investigation was defective. The special agent who conducted the investigation stated that he made no inquiry at the banks where petitioners had informed him they had turned in gold for cash (R. 86-87); that he did not check into the records of the County Clerk of Denver County to determine whether or not, in fact, properties were bought and sold by Mr. Holland at a profit as indicated in his statement (R. 94); and that he made no check of the records to determine whether or not it was true that petitioners had realized substantial profits as a result of certain restaurant sales (R. 99). Conceivably, it was these deficiencies in the investigation which led the Government's key witness to indicate doubt on the most critical element relating to the opening net worth computation—the cash fund.

The Government and the court below viewed the burden of establishing the opening net worth and indeed of establishing the offense as being satisfied by the mere introduction of circumstantial evidence relating to petitioners' financial history and calculated to demonstrate that the petitioners were not affluent during the years prior to the taxable period so that they could not have accumulated the cash fund. As previously indicated, the court below stated that the "ultimate and precise issue in the case was whether they [the jury] believed beyond a reasonable doubt from the established circumstances that there was no such fund in existence on January 1, 1946." (R. 350) That the Government should expect this form of evidence to be sufficient, either to establish the net worth starting point, or to establish a violation of the statute, is particularly extraordinary in light of the position which it took in its petition in *Calderon* v. *United States*, 207 F. 2d 377 (CA 9), certiorari granted 347 U. S. 1008. There, in contending that an extra-judicial admission relating to cash on hand need not be corroborated, the Government stated (Petition, p. 7):

> ". . . The amount of cash on hand is not in itself either the *corpus delicti* or an essential element of the offense of willful tax evasion. A conviction could not rest on such an admission alone. Without other evidence establishing that income received was not reported, the cash item would be meaningless."

Moreover, circumstantial evidence of financial history is so highly speculative and conjectural as to be of doubtful evidential value even for the most limited purposes. The speculative nature of the evidence is perhaps best demonstrated by the fact that petitioner Marion L. Holland, whom the Government pictures as on the brink of poverty for the 20-year period preceding the opening net worth date, was, in fact, during that period very actively engaged in the purchase and sale of securities on the stock market and, even according to the Government's computation, had on hand on the opening net worth starting point date stock originally costing approximately $30,000 and worth in excess of $52,000 (R. 95-96, 181, 189, 239). (Brief in Opposition, p. 8).

Thus, even assuming the competency of the petitioners' extra-judicial statements introduced by the Government, the net worth staring point evidence was so defective as to vitiate the entire net worth computations. The assumption of competency, however, is of doubtful validity in light of the Government's failure to comply with the requirement for corroborating extra-judicial statements. At the trial, petitioners did not take the stand. The prosecution, however, used their extra-judicial declarations to Government agents in two ways. First, because the petitioner Marion L. Holland declared that he had accumulated a substantial cash fund, the Government and the courts below took the position that refutation of that single hypothesis would suffice to establish the net worth staring point. Second, the Government and the courts below utilized the statements as an affirmative admission that no funds or

assets other than those stated existed on the net worth starting point date.[9]

The rule rendering incompetent as evidence, and insufficient as proof any extra-judicial confessions, admissions, or declarations which are not adequately corroborated by independent evidence, has been uniformly accepted by state and federal courts, notwithstanding that the policy of the rule has occasionally been questioned. *Warszower* v. *United States*, 312 U. S. 342; *Calderon* v. *United States*, 207 F. 2d 377 (CA 9), certiorari granted 347 U. S. 1008; *Spriggs* v. *United States*, 198 F. 2d 782 (CA 9); *United States* v. *Markman*, 193 F. 2d 574 (CA 2); *Bell* v. *United States*, 185 F. 2d 302 (CA 4), certiorari denied, 340 U. S. 930; *United States* v. *Fenwick*, 177 F. 2d 488 (CA 7); *Yost* v. *United States*, 157 F. 2d 147 (CA 4); *Ercoli* v. *United States*, 131 F. 2d 354 (CA D. C.); *Anderson, et al.* v. *United States*, 124 F. 2d 58 (CA 6); *Pines* v. *United States*, 123 F. 2d 825 (CA 8); *Gulotta* v. *United States*, 113 F. 2d 683 (CA 8); *Forte* v. *United States*, 94 F. 2d 236 (CA D. C.); *Tingle* v. *United States*, 38 F. 2d 573 (CA 8); *Goff* v. *United States*, 257 Fed. 294 (CA 8). While the corroborating evidence need not establish the corpus delicti beyond a reasonable doubt, the general rule requires that there be independent evidence tending to corroborate each element of the corpus delicti.[10] As stated in *Pines* v. *United States*, *supra*, p. 830:

> ". . . there is therefore lacking a vital link in the chain of circumstances by which it is sought to estab-

[9] In this connection, the Government sought in its brief in opposition (p. 8) to use the extra-judicial statement as a specific admission that on the net worth starting point date the petitioner only had those securities the subsequent sale of which was reflected in his income tax return for the year 1946. However, it has been pointed out in the reply to the brief in opposition that petitioner actually stated in his extra-judicial declaration that he did not know and was not sure whether he held securities in addition to those referred to (Reply to Brief in Opposition, p. 2) (R. 302).

[10] The corpus delicti is commonly defined as "the body or substance of the crime" and incorporates "The existence of a certain act or result forming the basis of the criminal charge, . . . and the existence of a criminal agency . . ." (23 C. J. S., Sec. 916).

> lish the transportation in interstate commerce. The corpus delicti includes not only the body or substance of the crime, but also the criminal means by which it was committed. The corroboration is not sufficient if it tends only to support the admission. It must embrace substantial evidence of the corpus delicti, though it need not in itself be sufficient proof of guilt."

Applying the doctrine to extra-judicial statements, courts have held, for example, that in crimes where scienter is a necessary element of the proof, there must be corroborating evidence specifically tending to establish guilty knowledge or intent. See, for example, *Forte* v. *United States*, 94 F. 2d 236 (CA D. C.); *Naftzger* v. *United States*, 200 Fed. 494 (CA 8). In the present case, however, apart from the circumstantial evidence relating to the financial history of the petitioners and to the cash fund hypothesis—a hypothesis suggested in an extra-judicial statement—there was virtually no independent evidence relating either to the net worth starting point or to the elements of the offense. At the minimum, the corpus delicti would have to include evidence tending to show that the petitioners understated their taxable income in the year for which they were convicted of violating Section 145 (b). There was no such evidence here.

The present case differs from the multitude of cases not based "solely on the circumstances of increased net worth" (R. 342), where the Government, by way of corroboration, was at least able to demonstrate willful failure to keep adequate books and records, undisclosed sources of taxable income, failure to reflect a multitude of financial transactions and specific individual items connoting probability of fraud. See cases cited *supra*, p. 26.

The Government's position, as indicated in other cases,[11] is that the rule requiring corroboration of extra-judicial admissions and declarations is limited solely to confessions

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[11] *E.g.*, Brief for the United States in Opposition, *Opper* v. *United States*, 211 F. 2d 719 (CA 6), certiorari granted 347 U. S. 1010.

of guilt. No sound basis for this distinction exists. An examination of many decisions reveals that the rule is customarily stated as applying in the case of confessions, admissions or declarations.[12]

Moreover, the distinction has been specifically rejected on several occasions. In *Spriggs* v. *United States*, 198 F. 2d 782, 783 (CA 9), the Court of Appeals commented:

> "Whether this evidence, upon which the judgment below must stand or fall, is to be regarded as a confession, or as admissions, or as extrajudicial statements, is of no consequence here. Under any name, they are insufficient to sustain the conviction, for there has been no independent proof of any crime having been committed. We deem it unnecessary to decide whether the lower court erred, as appellant contends, in admitting this testimony of certain government agents concerning statements made to them by appellant. Even if the admissibility of such testimony be assumed, arguendo, the government case still falls far short of establishing the guilt of appellant by the further evidence, required by our decision in Davena, Jr. v. United States, 9 Cir., 198 F. 2d 230."

Again, in *Gulotta* v. *United States*, 113 F. 2d 683, 685 (CA 8), the court stated:

> "A distinction between confessions and admissions as evidence in a criminal case is, for some purposes,

[12] For example, in *Goff* v. *United States*, 257 Fed. 294, 295 (CA 8), the Court of Appeals stated (3a) the rule as to "effect of statements or confessions in establishing the corpus delicti is as follows: 'A conviction upon *extra-judicial confession, or acts or declarations of a prisoner*, will not be sustained, without corroborative proof that the property was in fact stolen.'" In *Pines* v. *United States*, 123 F. 2d 825, 829 (CA 8), the same court stated "This, being the corpus delicti, could not be presumed, nor could it be established by *extra judicial declaration, confession or admission of the defendant*." In *United States* v. *Chapman*, 168 F. 2d 997, 1001 (CA 7), the court agreed with the taxpayer's contention that "the starting point must be based upon a solid foundation and a Revenue Agent's statement of the defendant's oral *admission or confession* when uncorroborated is not sufficient to convict." (Emphasis added.)

generally recognized. A confession is a declaration made by the accused admitting his participation in the crime with which he is charged. It is a direct acknowledgement of guilt. An admission is a statement, direct or implied, of facts tending to establish guilt. It is not an acknowledgement of guilt but of facts and circumstances, which, if taken in connection with proof of other facts, may permit an inference of guilt.

". . . If a false confession of guilt may be obtained from an innocent person by the use of coercion or flattery it is equally true that an admission of any element of the crime may also be obtained by the same means. On the principle that it is better for society that the guilty should occasionally escape than that the innocent should be punished, exceptions should not be grafted upon long-established rules until their need has been clearly demonstrated.

"The rule that to warrant conviction of a crime both confessions and admissions must be corroborated by some independent evidence is illustrated in cases very similar to the present. . . . Indeed, there is no sound reason why an uncorroborated voluntary admission of some element of crime should be given greater force as evidence of guilt than is accorded the accused's outright confession of the crime itself."

See also, *Ercoli* v. *United States*, 131 F. 2d 354, 356 (CA D. C.).

This Court itself has gone far toward eliminating any basis for such distinction in *Bram* v. *United States*, 168 U. S. 532. The question there was whether or not the extra-judicial statement used by the prosecution was admitted in evidence without a proper showing that it was voluntarily given. The defendant had vigorously denied his guilt, but the statements made in the process of denying guilt were used against him. This Court stated (p. 541):

". . . It is also clear that in determining whether the proper foundation was laid for its admission, we are not concerned with how far the confession tended to prove guilt. Having been offered as a confession and being admissible only because of that fact, a consideration of the measure of proof which resulted from it

> does not arise in its admissibility. If found to have been illegally admitted, reversible error will result, since the prosecution cannot on the one hand offer evidence to prove guilt, and which by the very offer is vouched for as tending to that end, and on the other hand for the purpose of avoiding the consequence of the error, caused by its wrongful admission, be heard to assert that the matter offered as a confession was not prejudicial because it did not tend to prove guilt. The principle on the subject is thus stated in a note to § 219 of Greenleaf on Evidence: 'The rule excludes, not only direct confessions, but any other declaration tending to implicate the prisoner in the crime charged, even though, in terms, it is an accusation of another, or a refusal to confess.' "

Although the *Bram* case involved the voluntary nature of the declaration, as distinguished from the rule requiring corroboration of a confession, there can be no distinction in principle. This is particularly so since the rationale of the Government's position in distinguishing between exculpatory and inculpatory statements is that only in the case of inculpatory statements is there a danger that the statement will be influenced by extraneous circumstances such as hope of reward or fear of reprisal and that therefore only such statements require corroboration. The *Bram* case implicity rejects such a contention.

### 2. Understatement of Taxable Income.

Even assuming that the Government established the opening net worth starting point, it would have succeeded only in taking the first step toward establishing a violation of Section 145 (b). Only the possibility that subsequent questioned expenditures were attributable to previously accumulated funds or assets would have been eliminated. Proof that petitioners understated their taxable income was still essential. As previously noted, there was no evidence of any item of unreported income, of any improper deduction, or of any undisclosed source of income (R. 342). In addition, there was no proof that the asserted increase

in net worth was attributable to taxable income; there was no attempt to identify the source of the asserted increase; there was not even any evidence tending to refute the possibility that asserted increases were attributable to particular non-taxable sources, such as gifts or inheritance. Indeed, there was no proof that Government agents had ever investigated the possibility of such non-taxable sources.

The Government in an effort to sustain the conviction here has seized upon and inflated a fragment of testimony as constituting independent evidence of understatement of income. Mr. Leonard DeLue, from whom Mr. Holland purchased the hotel, testified that in 1947 Mr. Holland stated "something . . . to the effect" (R. 35) that business had doubled and that he had already netted enough to pay for a half interest in the hotel. Keeping in mind the relationship of the parties and the casualness of the conversation, this testimony could have little probative value even for the period to which it related.[13] In any event, the evidential value of the alleged conversation which assertedly occurred in 1947 would by its context be strictly limited to the years 1946 and 1947, with respect to which the jury brought in verdicts of not guilty. That the Government should seek to utilize this fragment to support a conviction for the year 1948 to which it had no relation whatsoever, is indeed anomalous. The court below obviously considered this testimony to be entirely devoid of significance since it viewed the Government's case as resting "solely on the circumstances of increased net worth . . . to prove a substantial understatement of taxable income. . . ." (R. 342)

In the light of the general principles referred to under Heading II A, *supra*, relating to the burden of proof, no justification exists for assuming that the asserted increases in net worth reflected taxable income, for creating a pre-

[13] As a matter of fact, the evidence indicated that after Mr. Holland took over the hotel from Mr. DeLue he "lost substantial business" because of added competition (R. 37-38).

sumption to that effect or for shifting to petitioners the burden of proving that the increases in net worth were attributable to non-taxable sources. There was in fact a complete void in the Government's case, for there was not one iota of evidence that the petitioners understated their taxable income, thus evading or avoiding any tax lawfully imposed for the year 1948.

### 3. Willfulness.

Assuming that there was sufficient evidence of an understatement of taxable income, not one single item of evidence was introduced to justify submission of the case to the jury on the question of willfulness. As the previously cited cases indicate,[14] willfulness involves a specific intent which must be proven by independent evidence and which cannot be inferred from the mere understatement of income. Nothing offered by the Government at the trial remotely resembled the character of evidence which this Court has required[15] to prove willfulness in a prosecution under Section 145 (b). The evidential deficiency in this respect is spotlighted by the trial court's instruction on the question of willfulness (R. 215):[16]

> "It is not necessary for the Government to offer direct proof of any elements of this offense. It is enough if you are satisfied beyond a reasonable doubt by the circumstantial evidence in this case in making your decision and arriving at your verdict. You may infer wilfullness if the inference to your mind is reasonable from all the facts and circumstances in evidence. *You may consider Mr. and Mrs. Holland's relationship to each other, what each did in the business, and all of the acts in evidence that they have committed or failed to commit at any time.*" (Emphasis added.)

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[14] See p. 33, *supra*.

[15] *Spies* v. *United States*, 317 U. S. 492.

[16] While the trial court did not specifically instruct the jury that the necessary intent could be inferred from the understatement of income, there was, in fact, no independent evidence from which the jury could have drawn the inference.

That the inference of willfulness can arise from the marital relationship is novel. Nor can petitioners understand what "the acts in evidence that they have committed or failed to commit at any time" (R. 215) can possibly mean or refer to.

### 4. Supplementary Comment on Evidence.

Two additional aspects of the present case serve to emphasize its evidential weakness. Indictments were returned for the years 1946, 1947, and 1948. The starting point established by the Government was for the date January 1, 1946. All computations related back to that starting point. There was no dispute as to the fact or amount of subsequent expenditures or acquisitions. Notwithstanding the fact that the case was predicated solely on the circumstances of increased net worth, the jury brought in verdicts of "not guilty" for the years 1946 and 1947 and "guilty" for 1948. This is rendered all the more extraordinary by the fact that, based upon the net worth computations, the indictments charged evasions of tax in the approximate amounts of $15,000 for the year 1946, $14,000 for the year 1947, and $7,500 for the year 1948 (R. 7-8). Petitioners are not unfamiliar with the general principle that inconsistency of jury verdicts is not a matter for reversal. However, the inconsistency here assumes greater significance than is generally the case. See in this respect *United States* v. *George L. Allen* (S. D. Cal., October 20, 1950) Prentiss Hall, Para. 72,785, 1950 CCH 9494, where the trial court in granting a motion for judgment of acquittal, commented:

> "The relevancy of the action of the jury lies in the fact that the acquittal on Count 1 exculpates the defendant as to all matters relating to these two taxable years, 1944, 1945. Ordinarily, a tax evasion for one year is unrelated to a tax evasion for another year, but in this case, if the Government's theory was to prevail, if the jury believes Gauntt, then the pattern of fraud was the same in the first as it was in the second

count. Indeed Gauntt's complaint to the Internal Revenue Bureau delineating what he claims to be falsification of books and the like preceded the filing of the 1945 tax return. Indeed the information given to the investigator delineated the falsification of cash sheets, although Gauntt, in his testimony, claimed he knew nothing about the cash sheets on which the claim of discrepancy was based. It is strange that Gauntt, while disavowing knowledge as to these cash sheets, should have known in advance of their falsity. But be that as it may, the acquittal of the defendant by the jury in the first count indicates that the defendant is not guilty of the pattern of falsification which lay as the basis of both. The jury unconsciously has given support to the conclusion I have reached that the motion for judgment of acquittal made at the conclusion of all the evidence on which ruling was reserved should be granted."

The speculative nature of the evidence upon which the jury was allowed to bring in a judgment of guilty is also well illustrated in connection with the conviction here of Mrs. Holland. The Government's case against her was based on the following assumptions:

a. That there was an unaccounted for increase in net worth for the year 1948;

b. That the unreported income must have been the result of an understatement of gross receipts, there being no other potential source of income; and

c. That since Mrs. Holland prepared the daily sheets showing the gross receipts and turned them over to the bookkeeper, she must have at least aided and abetted a violation of Section 145 (b) (R. 193, 198).

The present case is an ominous example of what can happen when established and long-standing rules of proof are relaxed for asserledly practical considerations. Beginning with an uncertain starting point the Government proceeds in its attempt to establish unreported taxable in-

come, to substitute conjecture and assumption for proof. The consequence is that the taxpayer is faced with the choice of discarding the presumption of innocence and his constitutional right to maintain silence. He is jockeyed into the position where he must prove that asserted increases in net worth were not attributable to taxable income. Thus, he bears the burden of disproving an attempt to evade a lawfully imposed tax. To compound this departure from basic concepts, the case is submitted to the jury with no proof whatsoever of willfulness, the jury being left to infer willfulness from the asserted understatement of taxable income.

The present case should never have been permitted to go to the jury. Even assuming that resort to net worth computations was appropriate, the case was evidentially deficient from every standpoint. A reversal of the judgments with directions to enter judgments of acquittal is therefore required.

## III.

## THE TRIAL COURT'S INSTRUCTIONS.

Assuming the evidential sufficiency of the Government's case, the trial court's instructions were so erroneous and misleading as to constitute reversible error.

### A. Burden of Proof.

#### (1) Refusal to Instruct on the Requirements of Net Worth Proof.

Despite the judicially recognized need for caution in the application of the net worth technique to criminal cases, the trial court refused to grant either the text or substance of the instructions requested by the petitioners for the purpose of clearly informing the jury as to the requisites of a net worth case (See Instructions 11 and 15, R. 227-228, 229-230). The defendant requested the following instruction (R. 229-230):

"The Court instructs the jury that when the Government relies upon the circumstances of increased net worth and expenditures in excess of reported income to establish income tax evasion, as it does in this case, it must produce evidence that excludes all possible available sources of taxable income from which the increased net worth and the excess expenditures could have been derived. *The net worth expenditures method of establishing net income sought to be applied in this case is effective and can be considered only if the computations of net worth at the beginning and at the end of the question periods can reasonably be accepted as accurate. That is to say, it is incumbent on the Government to establish with accuracy the net worth of the defendants on January 1, 1946, which is the beginning of the period in question, and the net worth of the defendants on December 31, 1948, which is the end of the period in question.* If there is a reasonable doubt in your mind as to the computations of the Government as to the net worth of the defendants on either of these periods, or if there is a reasonable doubt in your mind as to whether the Government, in making its computations of net worth as to either of these periods, omitted assets of the defendants, such as cash on hand, stocks or other securities, then you should return a verdict of not guilty.

"One of the essential elements that the Government must establish in this case is that the defendants had no other assets on January 1, 1946, other than those which the Government contends they had on said date." (Emphasis added.)

Certainly petitioners were justified in requesting the trial court to instruct that in a net worth case the Government must establish the starting and ending points with accuracy. The failure to so instruct was particularly unjustified in light of the vigorous objections to the charge by counsel for the petitioners (R. 219-220):

"We particularly object to the charge your honor gave the jury because you have failed to instruct the jury on the principal element in the case, which is set forth in the tendered instructions that we offered to your honor before the charge was given. Instructions

Nos. 11 and 15. This being a net worth case, it is incumbent upon the prosecution to establish the net worth of the defendants at the beginning of the period in question with reasonable certainty; namely, January 1st, 1946, and also to establish the net worth of the defendants at the end of the period in question; namely, December 31st, 1948. If they fail to do that, and if they fail to include in the net worth at the beginning of the period assets which the defendants had at that time, then the entire cornerstone of their case has fallen and the jury should return a verdict of not guilty."

(2) Limitation and Shifting of the Burden of Proof.

The total effect of the trial court's instructions was to limit the Government's burden to that of discrediting a single hypothesis—the cash fund suggested in the petitioners' extra-judicial statements. Moreover, the phrasing of the instruction was such that it suggested to the jury that the petitioners were to be found guilty if they did not establish the veracity of this hypothesis or some other hypothesis of innocence. Thus, the trial court instructed the jury as follows (R. 209-210, 212-213):

"Now the defendant comes here and he claims through his counsel, first, that if he bought any property in '46, '47, and '48, he didn't pay for it out of any receipts from the business he is operating; that he paid for it out of the cash reserve of a hundred and four thousand, or a hundred and thirteen thousand dollars, which at different times it has been stated in here he had. He claims that he didn't accumulate that money after he bought the Holland House, nor in the taxable years in question here. He says he didn't get it from that source, and he denies that he failed to report all the earnings from that business. He says he had a hundred and four, or a hundred and thirteen thousand dollars, in ten dollar bills, and twenty dollar bills, and some hundred dollar bills. He says he kept that for years. He said he had that accumulated by 1933; that he kept it intact and didn't spend it from 1933 until 1946, and he says 'Sure, my

net worth increased at the end of '46, certainly increased further at the end of '47' and he said 'Of course it increased more still by the end of 1948.' But he said it increased by reason of the fact that 'I have reached into the black canvas bag' or his safety deposit box, or whatever else he kept it in, and he says, 'I have bought these properties and increased my net worth, as you say, by buying the property with that money, and not with money earned and unreported in the tax years in question.'

* * *

". . . Some emphasis was made in the arguments to you, Ladies and Gentlemen of the Jury, that there was no evidence here that any statement on the income tax returns for '46, '47, and '48 has been shown to be false. *That isn't the issue in this case.* The issue in this case is whether or not these defendants filed those income tax returns, reporting the income on those returns and the tax computed from it, knowingly and wilfully not including gross receipts from the business which the Government claims they earned, and which the Government claims they didn't report.

"The Government proceeds upon the theory that there was no such cash fund of a hundred and four thousand dollars, or a hundred and thirteen thousand dollars, and that the increases in their net worth each year were the result of purchases from receipts earned in the taxable years in question from that business. That is the Government's position.

* * *

"If you believe, Ladies and Gentlemen of the Jury, and are satisfied beyond a reasonable doubt that the Government's evidence that Mr. Holland and Mrs. Holland did not have that cash fund, or any other source of the money with which they increased their net worth except the gross receipts of this business in the taxable years in question, then you should bring in a verdict of guilty, if you also find Ladies and Gentlemen of the Jury that they have proved to your satisfaction, beyond a reasonable doubt, all of the essential and material elements of the charges in this indictment." (Emphasis added.)

Petitioners agree with the Government (Brief in Opposition, p. 11), that a careful search through the trial court's instructions may produce some language or phraseology in which it was suggested to the jury that more was involved than the discrediting of the cash fund theory. However, as the Government has so often argued, and the courts have so often held, the meaning of the court's instructions cannot be gleaned from a sentence or two selected from the text. The total effect of the instructions was to tell the jury that innocence or guilt depended upon cash fund or no cash fund. The Court of Appeals specifically adopted the view of the trial court in stating that it "agree[d] with the trial court that the ultimate and precise issue in this case was whether they [the jury] believed beyond a reasonable doubt from the established circumstances that there was no such fund in existence on January 1, 1946" (R. 350). Petitioners, on the other hand, maintain that the ultimate and precise issue was whether the Government proved beyond a reasonable doubt that they willfully attempted to evade or defeat a tax by filing or causing to be filed a false and fraudulent income tax return.[17]

Furthermore, the language of the court is confusing in that it suggested to the jury that unless petitioners proved the existence of the cash fund, or some other non-taxable source, a verdict of guilty should be returned. The present case is not unlike *Boatright* v. *United States*, 105 F. 2d 737,

[17] In its brief in opposition the Government places great emphasis on the phrase "or any other source of money with which they increased their net worth except the gross receipts of this business in the taxable years in question" (R. 213). This fragmentary sentence could hardly change the sense of the entire instruction. Perhaps even more important, this fragment was itself an erroneous statement of the law. No income tax is levied on the gross receipts of any business. *Anderson Oldsmobile, Inc.* v. *Hofferbert*, 102 F. Supp. 902, 904, affirmed 197 F. 2d 504 (CA 4). See also, *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179 and *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330. And the petitioners could very well have made new acquisitions out of gross receipts, viz. depreciation for one example, without having understated their taxable income.

740, where the Court of Appeals for the Eighth Circuit commented:

> "The court also charged the jury as follows: 'On the other hand, if you should find and believe from the evidence in this case that these defendants did not devise an artifice or scheme to defraud; that they did not make false and fraudulent representations or pretenses; that if such were made there was no intention on their part to defraud, and no intention on their part to obtain money or property by means of the representations made, then it would be your duty to find either one or both of them not guilty, according to what you believe, or either one of them, according to what you believe, if they were without fraudalent intent.'
>
> "The defendants complain that this shifted to them the burden of proving their innocence. It was, of course, incumbent upon the Government to prove every essential element of the offense charged. Unless the Government thus established the guilt of the defendants beyond a reasonable doubt, they were entitled to an acquittal. But this instruction placed upon the defendants the burden of convincing the jury that they did not devise a scheme, that they did not make false representations, that they did not intend to defraud, that they did not intend to obtain money by false pretenses. The instruction, we think, was erroneous. Drossos v. United States, 8 Cir., 2 F. 2d 538; State v. Trudell, 49 S. D. 532, 207 N. W. 465; Minner v. United States, *supra*."

See to the same general effect, *Bihn* v. *United States*, 328 U. S. 633; *Olender* v. *United States*, 210 F. 2d 795 (CA 9); *Nicola* v. *United States*, 72 F. 2d 780, 788 (CA 3).

(3) Burden of Proof Beyond a Reasonable Doubt.

The following instruction given by the trial court on reasonable doubt was clearly defective (R. 217):

> "I have used the term here, Ladies and Gentlemen of the Jury, of 'beyond a reasonable doubt.' It is not to be expected that you know what the Court means

by that language. So I am going to tell you what I mean. When I say that the Government must bring before you evidence which satisfies your minds beyond a reasonable doubt, the court does not mean that you should understand that the Government has the burden of satisfying you beyond every doubt, to remove every doubt, leaving no doubt at all. What we are talking about is a doubt based upon reason and common sense, in the exercise of your intelligence. It is a substantial doubt, not a trivial doubt; a significant doubt, not a flimsy one; a real doubt, and not an imaginary one. It's the kind of doubt, Ladies and Gentlemen of the Jury, which you folks in the more serious and important affairs of your own lives *might be willing to act upon.* Now if you feel such a *doubt about the Government's case,* it is your duty to acquit them." (Emphasis added.)

Assuming the propriety of a personal business test in a criminal case,[18] the trial court stated the proposition backwards. Obviously "the kind of doubt" is not such doubt as would lead the jury to act, but rather is one which would lead them to refrain from acting or to hesitate to act. Thus, in *Bishop* v. *United States,* 107 F. 2d 297, 303, the Court of Appeals for the District of Columbia, while approving the personal business test in that instruction, stated that the doubt was "such a doubt as would cause reasonble men to hesitate to act upon it in matters of importance to themselves." In *Commonwealth* v. *Miller,*

[18] Although this Court in *Hopt* v. *Utah,* 120 U. S. 430, 437, approved an instruction on reasonable doubt which incorporated the so-called personal business test, petitioners seriously doubt that satisfaction for the purposes of one's important personal business affairs is the proper standard to be applied in a criminal case in which an individual's life or liberty is at stake. Petitioners are inclined to believe, with the Court of Appeals for the Ninth Circuit, that this instruction was "approved because it was a part of an instruction which had fully explained the doctrine of reasonable doubt. We do not believe that court (the Supreme Court) will approve the business test when segregated from the other elements which were included in the instruction approved in *Hopt* v. *Utah, supra;*" *Paddock* v. *United States,* 79 F. 2d 872, 877 (CA 9).

139 Pa. 77, 21 Atl. 138, the Supreme Court of Pennsylvania made the following observation:

> "The fifteenth assignment relates to the definition of a 'reasonable doubt'. The learned judge said: 'It is such a doubt as would influence or control you in your actions in any of the important transactions of life.' He did not say that a doubt that would cause one to pause and hesitate was, if fairly derived from the evidence, a reasonable one within the meaning of the criminal law, but that it must be one that would control one's conduct in the important transactions of life. Our actions are determined by the preponderance of considerations. We doubt, hesitate, examine, balance the argument for and against the given action, and act as the preponderance indicates. A doubt that would control our actions in the important transactions of life would be one that was so strong as not to be overcome by the balancing process. *Such a doubt would be practically an unconquerable one. It would lead us not simply to refrain from acting, but to act.*" (Emphasis added.)

See also *State* v. *Rover*, 11 Nev. 343; *People* v. *Bemmerly*, 87 Cal. 117, 25 Pac. 266; *Lovett* v. *State*, 30 Fla. 142, 11 So. 550.

### B. Circumstantial Evidence.

The evidence being entirely circumstantial, the petitioners requested the trial court to instruct the jury that the evidence must be inconsistent with their innocence, excluding every reasonable hypothesis other than that of guilt (R. 227-228). The trial court not only refused to give such an instruction but gave no instruction which adequately defined circumstantial evidence or properly explained the nature or quality of such evidence so as to guide the jury in its evaluation thereof. Instead, it concluded its circumstantial evidence instruction as follows (R. 210-212):

> "You see this is a complicated case, Ladies and Gentlemen of the Jury, because there is a little bit of circumstantial evidence here, and a little bit of circumstantial evidence over there, and it's going to be your

> duty, Ladies and Gentlemen of the Jury, to arrive at your verdict on the basis of the facts proven to your satisfaction beyond a reasonable doubt, and also on the basis of the inference which reasonably may be drawn from those various facts and circumstances in evidence." (R. 211-212)

This instruction not only failed to explain adequately the circumstantial evidence rule, but suggested to the jury that the requirement for proof beyond a reasonable doubt did not apply to the inference which might reasonably be drawn from circumstantial evidence.

Sharp difference exists among the Courts of Appeals as to the so-called circumstantial evidence rule. The better rule is reflected in a multitude of cases which hold that where the evidence is circumstantial in nature the trial court is required to give the jury some form of instruction to the effect that the evidence must be inconsistent with every reasonable hypothesis but that of guilt. *Pollack* v. *United States*, 202 F. 2d 281 (CA 5); *Epstein* v. *United States*, 174 F. 2d 754, 769 (CA 6); *Strickland* v. *United States*, 155 F. 2d 167, 168 (CA 5); *Cross Co.* v. *Simmonds*, 96 F. 2d 482 (CA 8); *Stutz* v. *United States*, 47 F. 2d 1029 (CA 5); *Eierman* v. *United States*, 46 F. 2d 46 (CA 10); *Gurera* v. *United States*, 40 F. 2d 338, 340 (CA 8); *McLendon* v. *United States*, 13 F. 2d 777, 779 (CA 6); *Garst* v. *United States*, 180 Fed. 339 (CA 4). Particularly interesting to note is the adherence to the rule in criminal net worth cases. *Hanson* v. *United States*, 208 F. 2d 914 (CA 6); *Banks* v. *United States*, 204 F. 2d 666, 672 (CA 8); *Montgomery* v. *United States*, 203 F. 2d 887 (CA 5); *United States* v. *Fenwick*, 177 F. 2d 488, 490 (CA 7); *Bryan* v. *United States*, 175 F. 2d 223, 226 (CA 5), affirmed 338 U. S. 552. The reason for this is apparent. If the evidence is consistent with a reasonable and rational hypothesis of innocence the burden of proof has not been carried and the matter would be left "in the realm of rational speculation or conjecture." *Eierman* v. *United States*, *supra*, p. 48.

As stated by the Court of Appeals in *Cross Co.* v. *Simmonds*, 96 F. 2d 482, 486 (CA 8):

> "To submit to a jury a choice of possibilities is but to permit the jury to conjecture or guess, and where the evidence presents no more than such choice it is not substantial, and where proven facts give equal support to each of two inconsistent inferences, neither of them can be said to be established by substantial evidence and the judgment must go against the party upon whom rests the burden of sustaining one of the inferences as against the other. . . . The impossibility of proof of material facts, while a misfortune, does not change rules of evidence, and leaves the one having the burden of proof with a claim that is unenforcible. *Burnet* v. *Houston*, 283 U. S. 223, 51 S. Ct. 413, 75 L. Ed. 991."

The net worth case, based as it is on a crude and highly speculative technique of computing income, is precisely the kind of case which requires, for the proper guidance of the jury, a specific instruction that the jury is not to guess, or choose between speculative alternatives, but rather is to bring in a verdict of not guilty if the evidence is consistent with any reasonable hypothesis of innocence.

### C. Failure to Instruct on Statutory Basis of the Crime.

The trial court not only refused to instruct the jury as to the statute under which the petitioners were indicted,[19] but failed completely to define and explain properly the elements of the offense as set forth in the statute. Instead it submitted to the jury alternative theories of fact, using as its reference point the indictment as distinguished from

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[19] (R. 224): "Defendants' Requested Instruction No. 3. The Court instructs the jury that the indictment and the several counts therein contained are based upon Section 145 (b) of 26 U. S. C. which, so far as pertinent provides as follows: 'Any person required under this chapter to pay over any tax imposed by this chapter, who willfully fails to pay over such tax and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof shall' be guilty of crime."

the statute. In sustaining the trial court in this respect, the court below stated that "The substance of each count in the indictment was recited to the jury . . . every essential element of the crimes charged in the indictment was placed in issue . . . [and] the offense charged is embodied in the indictment" (R. 348). Thus the court below held that so long as an indictment states an offense, and the text or substance of the indictment is given to the jury, the trial court has fulfilled the requirement that it instruct the jury on the applicable statute. The better rule is to the contrary. See the decisions of the Court of Appeals for the Ninth Circuit in *Morris* v. *United States*, 156 F. 2d 525, and the decisions of the Court of Appeals for the Third Circuit in *United States* v. *Pincourt*, 159 F. 2d 917 (CA 3); *United States* v. *Levy*, 153 F. 2d 995; and *United States* v. *Noble*, 155 F. 2d 315. In the *Morris* case, *supra*, p. 527, involving an alleged violation of the Emergency Price Regulation Act, the trial court failed to define the offense as set forth in the statute, instructing instead with reference to the facts charged in the indictment. Even though this instruction was not assigned as error, the Court of Appeals reversed, holding that "the trial court committed fatal error in failing to instruct the jury on the statutes and regulations defining and governing the offenses charged. . . ." It specifically rejected the suggestion that an instruction on the statute could be supplanted by reference to the indictment (Footnote 4 of the opinion in the *Morris case*, *supra*, p. 531).

The Court of Appeals for the Third Circuit specifically adopted the rule in the *Morris* case in *United States* v. *Pincourt*, *supra*, p. 919:

> "Amendment 9 of the Regulation 445 was not explained, read or mentioned by the District Judge in his charge. Without the governing regulation being made plain to it, the jury could not have an informed judgment on the issue and the case did not go to it under the safeguards of correct procedure. Cf. Williams v. United States, 79 U. S. App. D. C. 299, 131 F. 2d 21, 22. The situation presented goes even further than the facts in the latest reported case in point,

> Morris v. United States, 9 Cir., 156 F. 2d 525, where the neglect to define the offense in the Court's charge was held not cured by stating to the jury what essential facts if proven would constitute a violation of a specific price regulation."

As the Government points out in its brief in opposition, p. 18, if careful scrutiny is given to the entire instruction of the trial court, the various elements of the statute will be found scattered throughout. But this misses the point. The defendant is entitled to have the statutory basis of the case explained to the jury in context.

In view of the evidential insufficiency of the present case, the court's action with respect to the granting and denial of instructions has only a secondary importance. Even if the case were evidentially sufficient, however, the rulings of the trial court with respect to its instructions would, at least when considered cumulatively, constitute grounds for granting a new trial.

## CONCLUSION.

For the reasons stated above, the judgments of the Court of Appeals should be reversed and the cases remanded to the District Court with directions to enter judgments of acquittal.

Respectfully submitted,

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